ENHANCING CANADA'S TRADE PROSPECTS: A BRITISH COLUMBIA PERSPECTIVE

presented to the

26th Annual Premiers' Conference

August 1985

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Premier
Province of British Columbia

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A. INTRODUCTION:

Canada is one of the world's major trading nations. In recent years, about 30% of all goods and services produced in Canada were exported and a correspondingly large share of our consumption has been imported from other countries. Moreover, Canada has traditionally had a greater dependence on international trade than most other countries including the U.S. and Japan, our most important trading partners. Compared to the 30% of our product which is exported, Japan exports about 15% of its total output and the U.S.A. roughly 10%.

Canadian economic activity is highly integrated by trade into the world economy. On the export side, the small size of the Canadian market relative to economies of scale in manufacturing is the major factor. Many Canadian producers must export in order to operate at efficient levels of production. On the other side of the equation, both producers and consumers depend on having access to a wide range of industrial and consumer goods and services available only on the international market. International trade is, therefore, essential to maintaining a dynamic efficient economic system in Canada — a system which is the foundation for our employment opportunities and our high standard of living.

The Canadian economy has shown only limited recovery since the 1982 recession and in a small open economy, experiencing persistent structural deficits, the traditional tools of macro-economic policy alone cannot be relied on for a solution. However, British Columbia believes that actions to increase trade flows — in other words, trade liberalization — would have a powerful stimulating effect on the Canadian economy. And this is a stimulus which can be achieved without budget outlays. An increase in trade, and the investment that it would stimulate, would contribute to productivity growth, reduce inflationary pressures and help alleviate unemployment.

The first step towards increasing trade would be the negotiation of new international agreements. Such agreements would not only assist existing Canadian exporters faced with trade barriers but would also stimulate an expansion in new productive investment in Canada. Current uncertainty regarding market access increases risk which, in turn, reduces investor confidence and investment levels. Strengthened commitments by trading nations to abide by clear rules governing international trade would impact favourably on Canadian investment, not only by ensuring increased access to key markets, but also by reducing uncertainty about future policy changes.

The liberalization of trade has long been acknowledged as a key force behind the economic progress we have made as a nation in the post World War II era. It is widely expected that the Macdonald Commission, in its final report, will confirm its interim views which recognized expanded trade with the U.S.A. as a vital element in Canada's economic future. The C.D. Howe Institute has reinforced the arguments in favour of freer Canada/U.S.A. trade with its recent publication on the subject. Similarly, the Premiers of the Western Provinces, at their meeting in Grand Prairie in May, indicated their support for liberalization of trade on both the multilateral and bilateral fronts.

Recent developments in the United States and in other countries strongly suggest, however, that Canada cannot take the international trade dimension of the economy for granted. The rise in protectionist sentiments, in the U.S.A., Europe and elsewhere, must be turned around if Canada is to be able to grow and prosper in the future. Of all our trading partners, the

United States is by far and away the most important, accounting as it does for something over 75% of our total exports. Our economic health is particularly dependent on the course of events in the U.S.A.

From sea to sea, continued access to the U.S. for Canadian commodities and products is being threatened by protectionist sentiment. We have experienced a number of trade disagreements with the United States in recent years. We have lost some and won some . . . and some of those we have won have been put back on the table by those in the U.S. Piecemeal negotiations — Canada's approach to these problems to date — are not in the country's best interest. With no demands of our own on the table, we have only to lose and, at best, we can fight to a draw. Moreover, the very nature of piecemeal negotiations is to focus attention soley on Canada's practices and policies (for example, alleged subsidies) rather than on a comparison of Canadian and U.S. policies.

In British Columbia's view, the best way to arrest protectionism and reverse the thrust toward the closing of markets is through trade negotiations to expand our access to foreign markets and make that access more secure. These negotiations should proceed on a parallel track. On the multilateral front, through the General Agreement on Tariffs and Trade (GATT) procedures, and on the bilateral front towards a comprehensive agreement with the United States. Discussions between the two federal administrations could be supplemented by other mechanisms, such as the recently announced Premiers'-Governors' Task Force on Trade. The urgency of the problems confronting Canada/U.S.A. trade, together with the complexity implied in the GATT, suggest that the Canada/U.S.A. issues should be handled directly and with dispatch. Any undertakings achieved through these talks, however, should be consistent with each country's obligations under the GATT.

Given the aforementioned considerations, this paper will briefly: (a) note the dimensions of Canada's international trade; (b) review several recent trade policy developments; and (c) indicate the direction that British Columbia believes the Canadian government should pursue in order to resolve our trade problems and expand our access to foreign markets.

B. CANADIAN TRADE AND INTERDEPENDENCE IN THE WORLD ECONOMY:[1]

In the post World War II era the value of Canadian merchandise exports (after adjustment for inflation) rose ten-fold amounting to (Cdn) $112 billion by 1984.[2] This export growth, combined with an equally dramatic increase in imports, served as a powerful stimulus to productivity gains, employment growth and economic expansion as Canadian companies focused their production processes in those areas where they were most efficient. This process of rationalizing production based on access to export markets had reached the point by 1981 that almost one-third of total production in the major manufacturing sectors was

[1] A more detailed treatment of material covered in this section can be found in the recent publication: Taking the Initiative: Canada's Trade Options in a Turbulent World; Richard Lipsey, Murray Smith, C.D. Howe Institute, 1985.

[2] International trade in services is increasing rapidly and there is good reason to believe that the income and efficiency gains from international trade in goods would also occur from increased trade in a variety of services. However, most of Canada's international trade is still composed of trade in goods and recent problems have involved traded goods. Therefore, the comments and statistics presented beyond this point in this paper are directed primarily to trade in goods (i.e. merchandise trade).

being exported. In certain sectors, the share of Canadian output sold in foreign markets was considerably above this level.

The expansion of exports, and the rationalization process which it has permitted, has contributed significantly to the opportunity for Canadian firms to increase the "value-added" in their products. At the same time, the range of Canadian exports has become much more diversified. Manufactured end products, for example, now account for 42% of all Canadian exports, compared to 1960 when only 8% of our exports fell into this category. The potential for increasing exports of manufactured end products due to freer trade is apparent from the rapid increase in these exports after the signing of the Automotive Products Trade Agreement with the U.S. in 1965. This agreement, which provided special rules to cover trade in the auto sector, was an important reason behind the dramatic increase of manufactured end product exports from Canada.

While all Canadian provinces are dependent on export markets, certain provinces are particularly sensitive to international developments due to the large share of output which must be sold abroad. Moreover, certain provinces — and British Columbia is one — rely on a relatively few products for the bulk of their export earnings. In British Columbia, for example, most of our forest products, coal and non-ferrous metals production is exported, and these commodities, together with natural gas, account for about 80% of all provincial exports.

Since trade is a two-way street, it is not surprising that imports as a share of Canadian consumption in various sectors have also increased over the years. For the major manufactured goods, about one-third of the Canadian market is now supplied by imports, compared to one-quarter 15 years ago. These import levels vary considerably from sector to sector but, overall, they are essential to Canadian manufacturing and non-manufacturing businesses alike — not to mention consumers — since it is through importation that critical products such as machinery and materials, and a wide variety of consumer goods, are made available to Canadians.

C. CHANGES IN CANADIAN MARKET FOCUS:

Canada's trade orientation has changed significantly in the past 40 years. The share of Canadian trade with the U.K., once Canada's most important trade partner, declined significantly after World War II, and this trend was reinforced by the U.K. decision to join the European Economic Community (EEC). The U.K. market now accounts for only 2% of Canadian exports. The pattern of Canadian trade with other Western European countries has paralleled trade with the U.K. — it has increased in absolute terms, but has declined relative to other export markets.

In the past 25 years, Asian markets have taken an increasing share of Canadian exports and now account for some 9% of the total. While growth in Asian imports of Canadian goods has slowed somewhat from the high levels in 1960's and 1970's, we expect continued strong growth in this market in the long-term.

While expansion of these and other markets is vital to Canada, it is the bilateral trading relationship between Canada and the U.S.A. which is critical to both countries. Our two-way trade with the U.S. amounted to some (U.S.) $115 billion in 1984. This represents a doubling

since 1977 when two-way trade amounted to just over (U.S.) $55 billion. The strong U.S. dollar has made Canadian goods increasingly competitive in the U.S. market and Canadian exports to the U.S. totalled (U.S.) $67 billion in 1984. The U.S. currently purchases 76% of all Canadian exports. Canada, on the other hand, is the United States' largest customer, purchasing more than (U.S.) $45 billion or some 20% of their export goods in 1984. Japan, the U.S.A.'s next largest customer, accounts for only about half of this amount. All of this points to the fact that both Canada and the U.S.A. have important interests in our two-way trade.

It is worth noting that British Columbia's experience is different from the Canadian average. This province's dependence on the U.S. market has actually declined in relative terms in the past decade while that for Canada as a whole has gone up. At present, about 75% of Canada's exports in total flow to the U.S.A., whereas the U.S. market currently accounts for only about 45% of British Columbia's total exports.

Trade between Canada and the United States has increased in almost all key sectors. The charts in Appendix 1 provide some historical detail on our export pattern. The five sectors depicted in these charts are among the largest in terms of total dollar exports. In this regard, the automotive sector stands out as being by far the largest exporting sector. And this sector has shown strong growth in recent years. Over time, Canada has tended to run a surplus in the resource sectors and a deficit for manufactured goods. The U.S. surplus in the high technology area has tended to grow in both absolute and relative terms.

D. EMERGING PROBLEMS IN INTERNATIONAL TRADE POLICY:

Trade is the sum of the business transactions between willing buyers and sellers. These transactions are more complicated than those within a country, however, because they occur across international boundaries under different legal and administrative practices, and in different currencies. In order to facilitate trade activity to the mutual advantage of all nations, certain "rules of the road" have been established. In recent years, however, these rules have been less strictly followed and to the extent that gaps in the rules exist, these gaps have been exploited. As a result, protectionist actions have been taken to the apparent short-term advantage of a particular country or sector within a country. This section briefly describes these rules and some of the recent problems with them. The emphasis here is on issues which are particularly relevant to Canada/U.S.A. trade.

1. *GATT— The Trade Policy Framework:*

The General Agreement on Tariffs and Trade (GATT), with some 90 contracting parties, is the key international treaty which regulates most world trade including much of Canada's trade with other countries. It is within the framework provided by the GATT that trade is conducted with the U.S. Initially negotiated in 1947, the GATT has been modified through successive rounds of trade negotiations. Until recently, it has provided a fairly effective mechanism through which countries have been able to cut import duties, reduce certain types of government interference with trade through non-tariff measures, and settle disputes.

The most recent multilateral trade negotiation, the Tokyo Round, concluded in 1979. It resulted in significant tariff cuts which will be fully implemented by 1987. In addition, the

Tokyo Round saw, for the first time, the signing of six so-called "non-tariff measure" agreements. These agreements cover: (a) Subsidies/countervailing duties, (b) Technical Barriers to Trade, (c) Government Procurement, (d) Import Licencing, (e) Customs Valuation, and (f) Civil Aircraft. Thus the GATT, following the Tokyo Round, provided a wide ranging framework under which world trade was to be expanded and enhanced.

However, significant trade policy problems have arisen over the past five years. Many countries are feeling pressure to protect key sectors and, given current levels of commitment, these problems may not be resolvable under the GATT as it currently stands. The severe recession of 1982, the continuance of high real interest rates, the misalignment of international exchange rates, the slow and uneven recovery of many western economies and the high rate of structural unemployment resulting from changing patterns of competition worldwide, have all contributed to the pressures in countries everywhere — including Canada — to "protect" what we now have. For example, in the U.S. much of the pressure for barriers against imports arises from the high level of imports in the U.S. market and the U.S. trade deficit which reached (U.S.) $123.5 billion in 1984 and may exceed (U.S.) $150 billion in 1985. The problem is that this attitude ignores the fact that expanded trade has been, and remains, the key to future economic prosperity for all nations.

2. *Current Trade Policy Issues:*

In order to understand the nature of the trade problem today, it is necessary to examine some of its key elements. Most important from Canada's point of view, given our position in the U.S. market, is the recent increase in U.S. non-tariff barriers. Of particular concern is the enormous increase in the frequency with which Americans are leaping to apply protectionist pressures through the invocation of administrative and legal procedures. In addition, individual members of Congress are taking legislative initiatives against imports whenever the existing trade law does not appear to be a sufficient barrier. The three examples of problem areas noted below are chosen for their particular relevance to Canadian interests.

(a) Emergency Safeguard Actions:

Under certain defined conditions set out in the GATT, a member country may temporarily adopt special import duties or quotas to restrict imports if they are increasing at such a rate as to cause market disruption in the importing country. The GATT is designed to encourage the gradual reallocation of production decisions in response to competition, so this safeguard provision was designed to be used sparingly and only on a temporary basis when the displacement of locally produced goods is occurring too quickly and the adjustment costs, in terms of people and resources, are excessive.

Unfortunately, in the past five years, countries faced with adjustment problems have increasingly used "grey" areas of the GATT to restrict trade in the fashion of the "safeguard" option. The key example of this at present is the negotiation of so-called "voluntary export restraints" (VERs) with countries whose products are alleged to be causing market disruption. There are many examples of this phenomenon: the U.S. has negotiated several VERs on steel products and automobiles; certain EEC countries have bilateral VERs with Japan covering a number of products; and Canada has a VER arrangement with Japan on automobiles.

The growth of VERs in international trade constitutes a dangerous precedent because it foreshadows a return to managed trade, inhibits positive adjustment, and tends to legitimize unwarranted requests for protection from competition with imports. Since there are no international treaties regulating these VERs, Canadian exports are at risk — particularly with the U.S. Take for example the many actions now before the U.S. Congress. U.S. Representative Bonker's bill (H.R. 1648 — The Wood Products Trade Act of 1985) for one, has as its major objective the establishment of a VER with Canada limiting Canadian wood products exports to the U.S. Similar actions or suggestions for action have arisen related to other sectors including steel. In this environment, can "protectionist" measures under the guise of safeguards be far behind for other areas such as automotive trade?

(b) Subsidy/Countervail Law:

The GATT and its Subsidy/Countervail Code permit an importing country to apply a countervailing duty to subsidized imports when these imports are causing serious injury to domestic producers. A properly applied countervailing duty is not considered protectionist as it theoretically restores the competitive balance that would have existed in the absence of a subsidy. However, the incidence of countervailing duty cases has increased, particularly in the U.S. where 139 cases were filed in the four year period commencing July, 1980. While only three of these requests for countervailing duties were filed against Canada, recently we have been confronted with a rapidly increasing number of cases. For example, a U.S. countervailing duty was recently imposed on all live hog imports from Canada. B.C. raspberry producers recently learned, after spending almost one year defending their interests against an "anti-dumping suit" in the U.S., that they are now facing a countervailing duty case as well.

The factors which influence the rate at which countervailing duty cases are filed are numerous and complex. The existence of targetted assistance programs in the exporting country, excess productive capacity in the importing country, and exchange rate fluctuation are just some of the more important factors which will always be in play. However, these risks, some of which are inherent in any business transactions, are currently being exacerbated by uncertainty about trade policies and how they will be applied.

The lack of agreed GATT definitions of critical terms used in a subsidy/countervail case has resulted in internal pressures, particularly in the U.S. to define these terms in an arbitrary way. Since these definitions are set out in domestic legislation and are subject to change, there is the risk that individual countries will adopt special standards in order to protect domestic industry from normal import competition. For example, there is currently a joint government /industry effort underway in Canada to fight attempts by certain interests in the U.S. to redefine resource "subsidies" under the U.S. countervailing duty law. If the definition of "subsidy" under U.S. law is expanded as proposed by certain U.S. Congressmen, exports related to a number of Canadian natural resource products — and processed products such as aluminum and petrochemicals that have a significant resource input — would be put at risk.

Although the above discussion has largely focused on bilateral Canada/U.S. problems, the Subsidy/Countervail problem in international trade is broader and affects trade between other countries as well as our exports to third country markets.

(c) GATT Dispute Settlement:

It is not possible in the scope of this paper to detail current problems in GATT dispute settlement procedures. However, it is generally agreed that the problems with the substantive provisions of GATT, such as the two areas noted above, have been aggravated by the weaknesses inherent in the current dispute settlement practices. Because the GATT system and dispute settlement procedures rely strongly on building consensus on key issues, it is difficult to resolve trade disputes based on differences in interpretation, particularly when major trading countries are involved.

Relating this to the Canada/U.S. trade issue, it is clear that many of our problems are primarily bilateral, at least at present. Thus, resort to existing dispute settlement mechanisms provided under the GATT offers little chance for a timely and effective settlement.

3. *Access to International Markets:*

Just as Canada's economic health is inextricably tied to its ability to trade, our ability to trade depends on access to foreign markets and our willingness to import. Recent developments in international trade, such as those noted above, raise serious questions about whether Canada can continue to rely on existing international trade agreements to secure access to foreign markets, especially those of the U.S.

The quality of access to foreign markets depends essentially on two factors:

(a) the level of tariffs and "non-tariff measures" in a foreign country; and

(b) the extent of the commitment, if any, on the part of an importing nation not to take arbitrary future actions to reduce access to the market.

Without a firm and clear set of understandings among nations, these elements of market access are simply not attainable. While another round of the GATT is a vital step in achieving the objective of improving world-wide prosperity through expanded trade, this would simply not be a sufficient vehicle to facilitate a solution to the current problems in Canada/U.S.A. trade relations. The complexity implied in another GATT round — where there may be as many as 90 or more very active players makes it likely that it will be years before an agreement is finally signed. The problems plaguing U.S./Canada trade are "here and now" and demand immediate attention.

Since Canada's most urgent trade priorities relate primarily to the U.S. market, we must look for the means to quickly and effectively address our interests in that market.

E. A PARALLEL APPROACH — BILATERAL AND MULTILATERAL NEGOTIATIONS:

Access to the U.S. market is and must remain an essential objective for Canadian trade policy for the foreseeable future. At the same time, other markets — such as, the EEC and the Pacific Rim — are important to Canada and critical for certain provinces and many producers. For these reasons, British Columbia believes that Canada should embark on parallel, complementary fronts: bilateral negotiations with the U.S. with a view to concluding a comprehensive trade agreement; and multilateral efforts with other countries, including the U.S., with the objective of launching a new round of negotiations to strengthen the GATT system. The negotiations on both fronts should address the level of protection that exists today and seek to reduce the risk of arbitrary changes in the future.

This parallel approach is possible because GATT Article XXIV specifically authorizes preferential trade agreements provided they meet certain requirements. Generally speaking, a parallel approach would permit Canada and the U.S. to eliminate tariffs in cross-border trade and adopt special rules for dealing with a variety of the bilateral trade irritants caused by the application of non-tariff measures. At the same time, both countries should continue to pursue world-wide trade liberalization through multilateral negotiations under the GATT.

With this approach, therefore, the GATT would remain the trade policy framework for Canada and the U.S. both for those matters not covered in a comprehensive agreement as well as for all Canada and U.S. trade with other countries.

The remainder of this paper will briefly outline some of the more important elements which the Government of British Columbia believes are critical to an agreement with the U.S. Summary comments are also made on some of the factors which will merit careful consideration as Canada formulates its position on U.S./Canada negotiations including: adjustment costs; harmonization of economic policies; bargaining leverage; and socio/political factors.

F. A COMPREHENSIVE CANADA/U.S. TRADE AGREEMENT:

An unparalleled stream of actions are being taken within the U.S.A. to restrict the inflow of goods from countries all over the world. In some cases, these restrictions are a result of actions taken by individual American industries under the existing legal framework: the recent ruling against Canadian hogs; the countervail petition against Canadian fish; a ruling against Korean oil rigs; a quota against Brazilian shoes; and others. In other cases, actions are being taken in Congress to change the law: Representative Gibbons' Bill respecting natural resource subsidies; Senator Thurmond's textile Bill which would restrict clothing imports from developing countries; and Representative Rostenkowski's Bill to place 25% import surcharges on all products from countries with "excessive" trade surpluses with the U.S. (Japan, Brazil, Taiwan and South Korea are, at present, the target countries).

The actions being contemplated in these bills are obviously varied, ranging from broad new tariffs to quotas on specific products. It is British Columbia's view that this multi-sector, multi-faceted kind of activity in the U.S.A. can only be turned back by launching single negotiation

covering all aspects of our two-way trade. The Canadian response to date, which has consisted of tackling each trade problem independently as it arises, has many weaknesses. Too often, ad hoc reactions by Canada, on a peacemeal basis to particular disputes, fail to deal with the root causes of trade problems.

A comprehensive trade agreement between Canada and the U.S.A., on the other hand, would tend to counter the existing protectionist sentiment in the U.S.A. and to provide the private sector in both countries with a more stable and certain environment within which to do business. Both countries would also benefit from the broadening of the range of duty free goods, many of which would still be duty free after the tariff cuts embodied in the Tokyo Round agreements. Finally, implementation of the agreement by way of a treaty between the two countries would offer benefits in terms of increased certainty for business on both sides of the border. Each of these elements of a possible comprehensive trade agreement (i.e. Non-tariff Measures, Tariffs and Implementation) is discussed briefly below.

1. *Non-tariff Measures:*

Article XXIV of the GATT allows members of a free trade area considerable scope to adopt preferential bilateral mechanisms and rules to deal with bilateral trade problems, including those caused by non-tariff measures. In the area of "safeguards", for example, it is envisaged that Canada and the U.S. would deal with disruptive imports through a bilateral mechanism focusing on cross-border trade. With the bilateral focus, safeguard procedures could be made more precise and transparent, and the present level of uncertainty in their application could be reduced. Moreover, the agreement could contain a provision whereby each country would be protected from the "side-swipe effect" of GATT sanctioned safeguard actions taken against third countries. For example, in contrast with existing practice, Canada could be exempted from United States safeguard actions against other countries.

Another major objective in regard to non-tariff barriers is the negotiation of new definitions and procedures for cases involving subsidies or sales at "less than fair market value". Clear and precise definitions of such terms as "subsidy", when combined with technical modifications to Canada and U.S. trade laws, would significantly reduce the threat and uncertainty which clouds Canada's current access to the U.S. market. Beyond these two items, a host of other areas would have to be addressed within a comprehensive agreement. Government procurement and technical product standards are two particularly complex areas which would have to be examined.

2. *Tariffs:*

Under a GATT Article XXIV free-trade arrangement, import duties on substantially all the trade between the two countries must be eliminated. Generally, the phasing out of tariffs is done slowly over a considerable length of time (often ten years) so as to ease the adjustment process. Not all products need to be covered under the agreement, so there is scope for exemption which would be negotiated in advance of signing the agreement. Exempted items would still be dutiable at the usual GATT rate.

The trade gains from tariff liberalization are expected to be significant because, even with final implementation of the Tokyo Round tariff cuts on January 1, 1987, Canada will still have high tariffs on clothing and textiles, plastics, furniture, footwear, and electrical appliances,

while the U.S. will still have relatively high tariffs on petrochemical products, textiles and clothing, footwear, and glass, plastic and metal products. Under the free trade arrangement provision of GATT, both Canada and the U.S. would maintain their existing separate tariff structures vis-a-vis third countries, and a "rule of origin" clause would have to be set out in the bilateral agreement to limit bilateral free trade to products which were substantially U.S. or Canadian.

3. *Implementation:*

The successful conclusion of a bilateral trade agreement would increase certainty and predictability regarding "rules of the road". Once these rules are made part of a bilateral trade agreement, the further step of implementing it by way of a ratified treaty would make it much more difficult for individual members of Congress to get support behind a Bill to change them unilaterally.

G. CANADIAN CONCERNS ABOUT CANADA/U.S.A. TRADE AGREEMENT:

The idea of a comprehensive trade agreement with the U.S. raises a number of concerns among Canadians. It is the position of the Government of British Columbia, however, that none of these concerns, looked at separately or as a group, would outweigh the long-term benefits to Canada from an agreement which effectively liberalized trade. The four most often cited concerns are discussed below.

1. *Adjustment Costs:*

There is considerable sensitivity in Canada to the investment and employment implications of liberalizing trade. Pressures to adjust to new competition from foreign sources are not new in Canada. As a result of earlier trade negotiations Canadian producers in certain sectors have seen their historical share of the Canadian market decline due to imports. In some cases this competition has put pressure on Canadian businesses and their employees to move into more productive fields. These adjustment costs caused by increased international trade can be substantial, particularly at the level of the individual employee.

However, adjustment to the effects of trade liberalization to-date, as a result of changes negotiated within the GATT, have been less painful than one might conclude from focusing only on adversely affected companies or industries. Experience has shown that adjustment costs are temporary, and that they are more than balanced by employment, efficiency, and income gains caused by expansion in "growth" sectors of the economy and by the greater availability and lower prices of consumer goods.

It should also be remembered that Canada, like other nations around the world, has been experiencing economic adjustment continuously since World War II. The result of this adjustment has been expanded employment and growth. It is where there have been attempts to thwart this adjustment that the costs of a stagnant economy have been most pronounced.

Nevertheless, measures should be taken to keep adjustment costs to a minimum and to assist companies and their employees to adjust in a positive way to the new competitive environment. A number of steps can be taken to achieve this. Of particular importance is the transition period for implementation which may need to be lengthy and may vary from sector to sector, in order to ensure that individuals in industries which decline in the face of freer trade can move to new growth sectors. In a few cases, where there are overriding policy objectives, it may be necessary to exempt a class of goods from the agreement. As noted above, there is scope to do this within GATT Article XXIV.

2. *Harmonization of Economic Policies:*

There is no GATT requirement under the Article XXIV free trade area provision that Canada and the U.S. harmonize or change any of their fiscal or monetary policies including tax policies and expenditure programs. Because of the mobility of investment capital, technology and people with critical skills, however, there has always been some pressure on government, whether at the national or sub-national level, not to adopt tax policies which place producers at a major disadvantage relative to their competitors in other jurisdictions. Even though these pressures exist today in Canada, they have not led to a complete harmonization in provincial fiscal policies nor is it anticipated that harmonization would develop to an undesirable degree from a Canada/U.S. trade agreement.

3. *The Bargaining Chips:*

People often ask what Canadians would be willing to give up in order to secure a comprehensive trade agreement with the U.S. In doing so, they often cite as possibilities the important elements of Canada's social infrastructure such as state medical care. The spectre is raised that Canada would be stripped of her policy independence in many of our most cherished areas of social policy.

This line of argument is simply unfounded, and is not applicable to today's circumstances. Canada has enough to offer the U.S., and enough bargaining leverage in any negotiation, to ensure that those matters which are strictly domestic — and our social infrastructure is certainly in this category — do not become elements within the negotiation. The gains to the U.S. from enhanced trade in key sectors, for example high-technology goods, together with the U.S. interest in demonstrating to the other trading nations the value of comprehensive trading arrangements, will provide sufficient basis for a balanced negotiation.

4. *Political Implications of a Free Trade Arrangement:*

It is not possible within the scope of this paper to do much more than note this area as one of major concern to Canadians. Any international agreement involves some limitations on sovereignty. Canada has signed many international agreements because Canadians believe these agreements have furthered their interests by extending application of the principle that the rule of law, rather than power alone, should govern nation state behaviour. A free-trade agreement with the U.S., based on agreed rules, would further this process by reducing, if not eliminating, the problems we have experienced recently in our trade relations with the United States.

For reasons that are understandable, there is not one case of a political union having evolved after a GATT Article XXIV free trade agreement was negotiated. In the case of two of the

most noteworthy examples of free-trade agreements — that between Australia and New Zealand and the European Free Trade Areas made up of Iceland and a number of European countries — the continuing independence of the individual nations is clear. Moreover, this statement is true even with respect to customs unions and common markets which involve a greater degree of economic integration. It is the view of the British Columbia Government that a free trade arrangement with the U.S. would not compromise any of Canada's political objectives.

H. CONCLUSION:

It is critically important now, and will likely become even more so in the future, that Canada take steps to broaden and secure its access to the U.S. market. Canada's relatively small and geographically diverse market impedes the ability of Canadian firms to gain the competitive edge that comes through secure access to markets of much larger size. It is also important to Canada to ensure that rules for trade with countries other than the United States are clear, understandable and enforceable. In order to achieve both of these goals, British Columbia believes that the Government of Canada should begin discussions as soon as possible with the United States Administration aimed at concluding a comprehensive trade agreement under the provisions provided within the GATT. These discussions could be supplemented by other mechanisms such as the recently formed Premiers'-Governors' Task Force on Trade. On a parallel track, Canada should vigorously promote the launch of a new round of multilateral trade talks.

While, in various circles, much attention is devoted to the potential negative consequences of pursuing a trade arrangement with the U.S.A. — and the consequences cited are both economic and socio-political — too little attention is given to the consequences of *not* proceeding with a Canada/U.S.A. trade agreement. It is the position of the Government of British Columbia that to drag our feet today, using the need for further study and analysis as an excuse for inaction, will effectively imply a decision by Canada to accept higher unemployment, slower growth and more economic hardship than our citizens need to bear.

With regard to analysis and the implications of freer trade with the U.S., there are a number of studies underway in Canada both by governments and the private sector. While these studies will be useful in determining our detailed objectives in a negotiation and in estimating the specific effects of an agreement, it must also be recognized, that however much we may regret it — there are no facts in the future.

In the longer run, a decision not to enter into talks with the U.S.A., or to stall the initiative today (which, because of the "time windows" available to us, could mean losing our opportunity to achieve an agreement), could mean an actual decline in the economic well-being of all of us. We, as Canadians, must ask ourselves whether or not this is a price we are willing to pay.

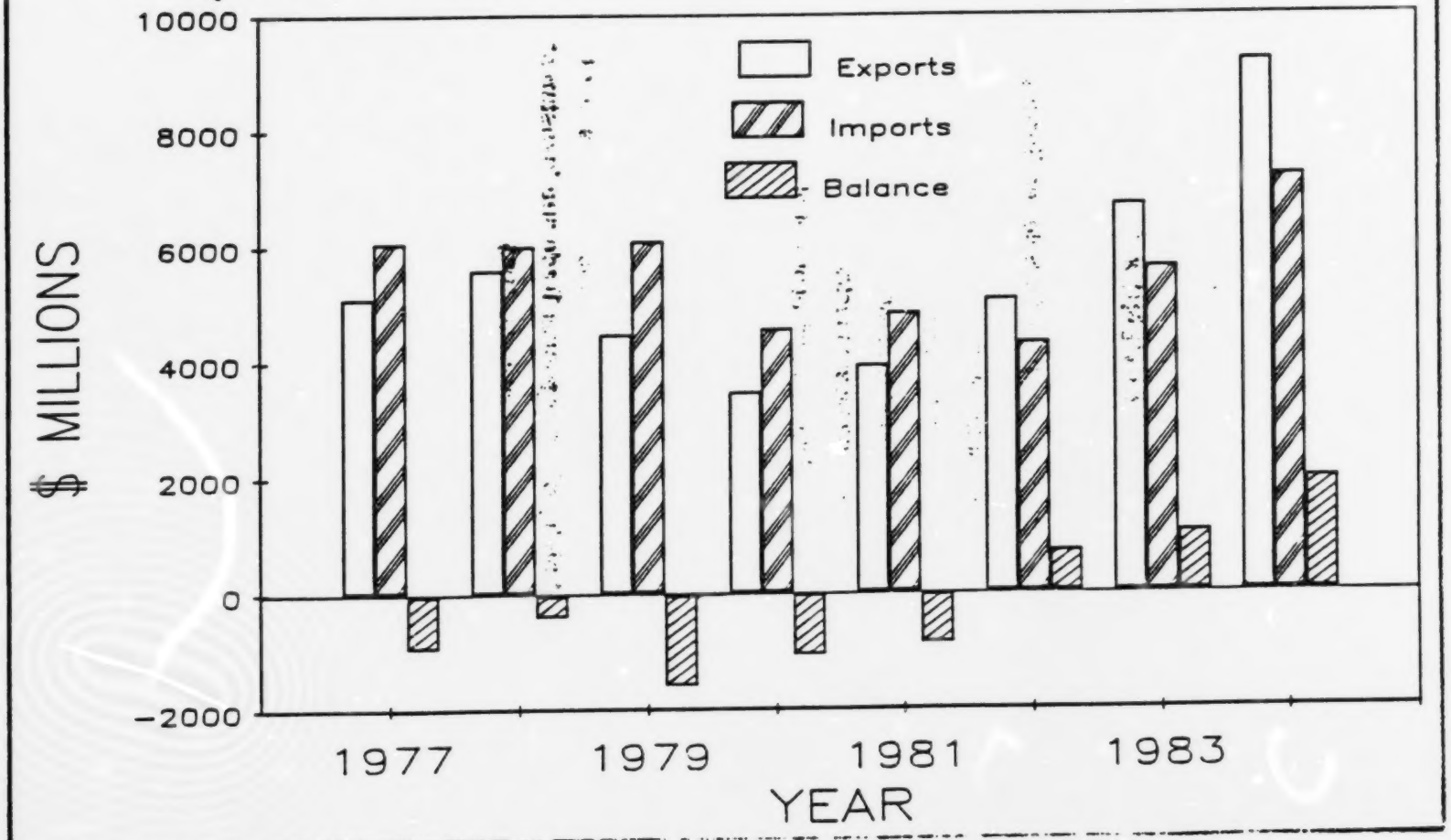
APPENDIX 1

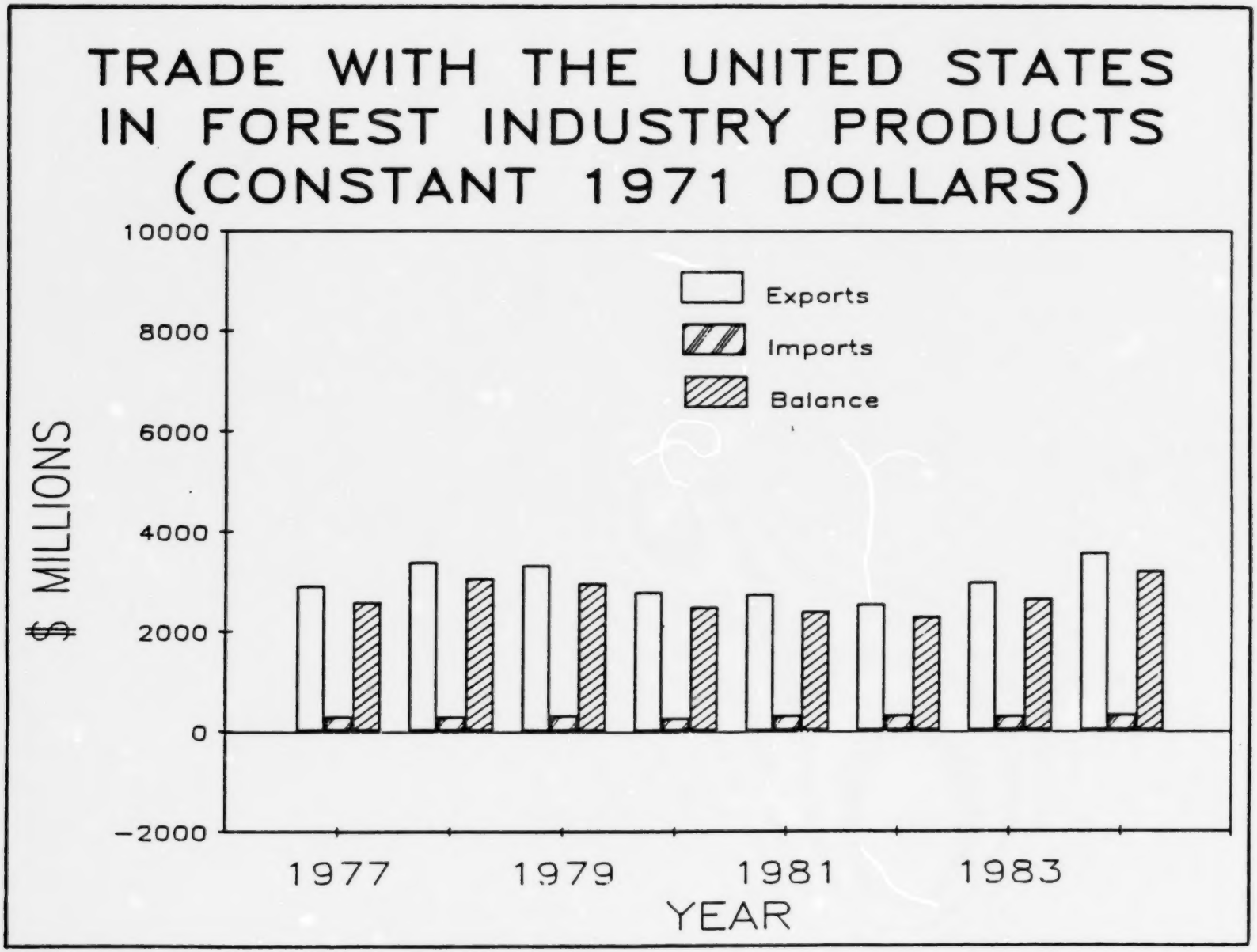
Canada/U.S.A. Trade for Selected Sectors

— Automotive
— Forest Industry
— Non-ferrous Metals
— Chemical Industry
— Telecommunications et al

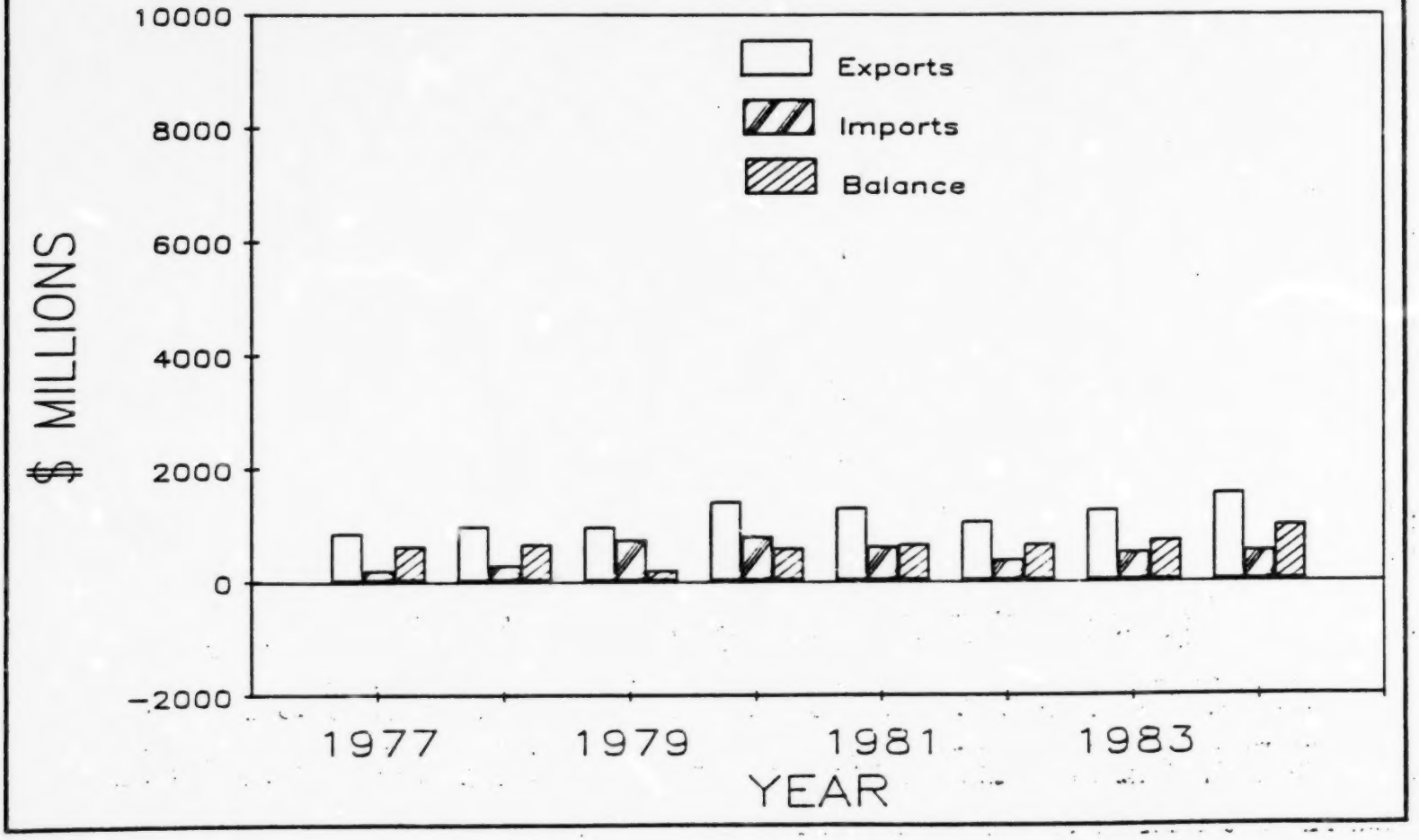
Ministry of International Trade and Investment
August, 1985

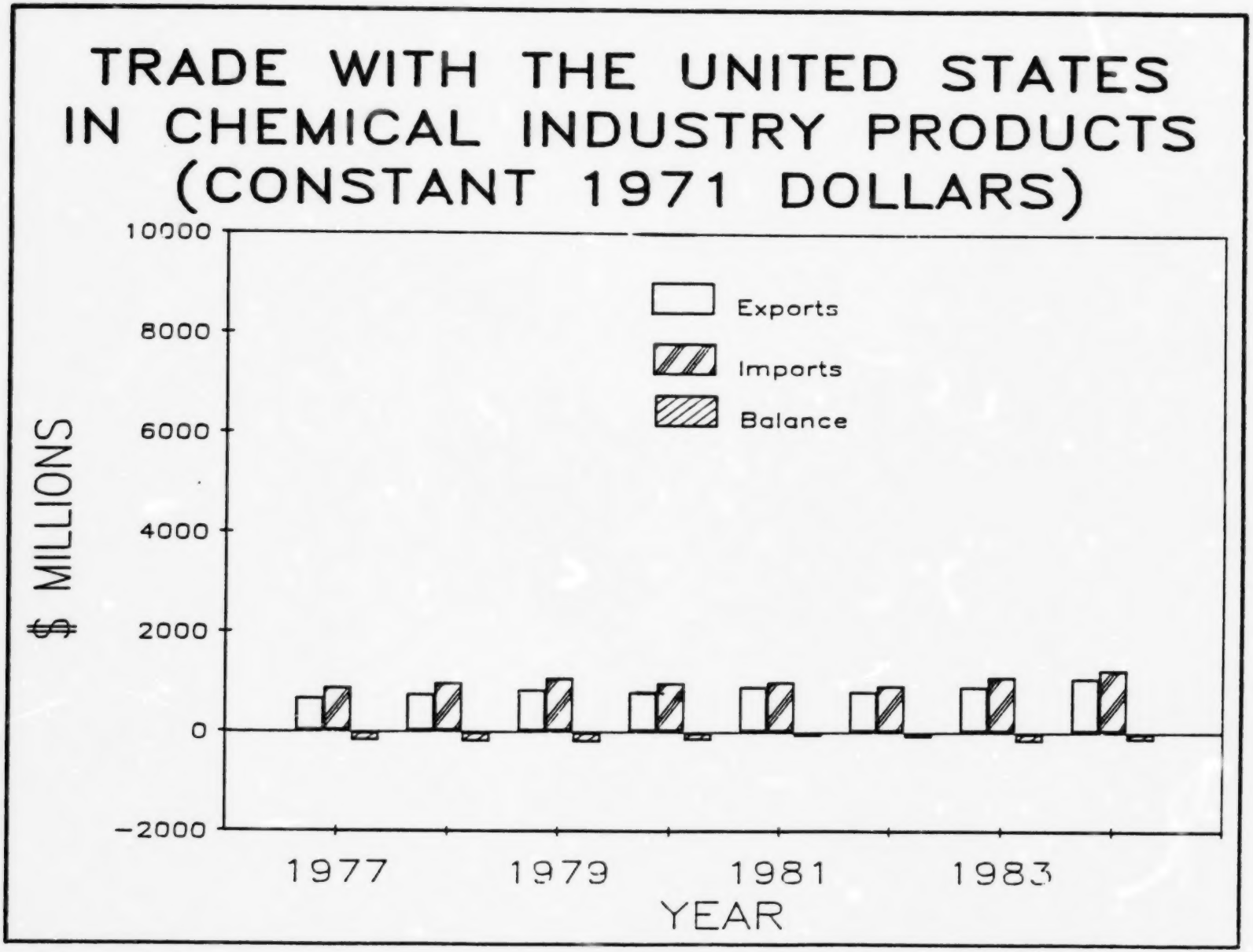
TRADE WITH THE UNITED STATES IN AUTOMOTIVE PRODUCTS (CONSTANT 1971 DOLLARS)




TRADE WITH THE UNITED STATES
IN FOREST INDUSTRY PRODUCTS
(CONSTANT 1971 DOLLARS)
10000
8000
6000
4000
2000
0
-2000
$ MILLIONS
Exports
Imports
Balance
1977
1979
1981
1983
YEAR

TRADE WITH THE UNITED STATES IN NON-FERROUS METAL PRODUCTS (CONSTANT 1971 DOLLARS)




TRADE WITH THE UNITED STATES
IN CHEMICAL INDUSTRY PRODUCTS
(CONSTANT 1971 DOLLARS)
10000
8000
6000
4000
2000
0
-2000
$ MILLIONS
Exports
Imports
Balance
1977
1979
1981
1983
YEAR

TRADE WITH THE UNITED STATES IN TELECOMMUNICATIONS, COMPUTER, OFFICE AND RELATED EQUIPMENT (CONSTANT 1971 DOLLARS)